UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO

In re:	)	
	)	
KARL JOHN KOCH	)	Case No. 09-32097-SBB
	)	Chapter 11
Debtor	)	
SS#xxx-xx-7409	)	
_____	)	
	)	
17250 West Colfax Holdings, LLC,	)	
Movant(s),	)	
v.	)	
Karl John Koch,	)	
Respondent(s).	)	

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER
ON
17250 WEST COLFAX HOLDINGS, LLC'S
MOTION FOR RELIEF FROM AUTOMATIC STAY

THIS MATTER comes before the Court on the Motion for Relief from the Automatic Stay (the "Motion") filed on November 11, 2009 (Docket #41) by the secured creditor, 17250 West Colfax Holdings, LLC ("Lender"), seeking relief from the automatic stay under section 362(d) of the Bankruptcy Code in order for Lender to exercise its state law rights and remedies, including the continuation of a foreclosure proceeding, as to the property located at 17250 West Colfax Avenue, Golden Colorado. Having considered the testimony of witnesses at hearings held on January 7 and 28, 2010, the exhibits admitted, and the arguments of counsel, and having reviewed the evidence submitted, the file in this matter, and the relevant case law, the Court makes the following findings of fact and conclusions of law, and issues the following order on the Motion as follows:

Issues Presented and Summary Conclusion

The issue before this Court is whether the Lender is entitled to relief from stay under § 362(d)(2) of the Bankruptcy Code because Debtor has no equity in the Property and the Property is not necessary for an effective reorganization.

For the reasons set forth below, the Motion is granted. First, the Court finds and concludes that, while the second Deed of Trust in favor of Klaus Landau is found to have been released by Landau, still the Lender has met its burden and shown that the Debtor has little or no equity in the Property. Second, based primarily on the strength of the testimony of the Lender's appraiser, Mr. Mark Lodmill, and of the Golden City Planner's Office representative, Mr.

Kenneth Tribby, the Court finds and concludes that both operating costs of the Debtor's Property and the costs of converting the Property from apartments to condominiums are understated by the Debtor—thus, the Debtor has not met its burden of demonstrating that the Property is "necessary for an effective reorganization that is in prospect," as that term is defined in *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.,* 484 U.S. 365, 108 S.Ct. 626 (1988).

Findings of Fact and Conclusions of Law

I. General Facts

1. The Debtor, Karl John Koch, filed this Chapter 11 case on October 19, 2009 (the "Petition Date").

2. The Debtor is the owner of a 29-unit apartment complex located at 17250 West Colfax Avenue, Golden Colorado (the "Property"). According to the Debtor's Declaration, most of the units are leased, and the gross rents and income from the Property is, if fully leased, $25,500 per month or $306,000 per year.

3. The Lender is the owner and holder of a MultiFamily Note, dated February 6, 2006, in the principal amount of $2,766,400 (the "Note"). The Note is secured by a MultiFamily Deed of Trust, Assignment of Rents and Security Agreement, dated February 6, 2006 (the "Deed of Trust") which encumbers the Property.

4. The monthly payment currently owed under the Note is $19,490.92. As of the Petition Date, Debtor owed $2,823,095 to Lender. The Parties stipulated that after the Petition Date, the Debtor paid Lender $68,913, reducing this figure to $2,754,182.[1]

5. On the Petition Date, the Property was also encumbered by a second deed of trust in the amount of $410,000 for the benefit of Klaus Landau (the "Second Deed of Trust").

6. Combining the Lender's Deed of Trust and the Second Deed of Trust, the Court finds that the total debt on the Property was $3,233,095 as of the Petition date. The amount of debt on the Property at the continued hearing on January 28, 2010 was subject to dispute.

[1] Exhibit 4 indicates that of the $19,490.92 monthly payment, $1,703.24 is escrowed for the payment of property taxes and $664.42 is escrowed for the payment of insurance on the property. By applying the $68,913 to the amount owed the Lender on the Petition Date, no escrows are being created by the Lender for taxes and insurance. It is the undisputed testimony of Mr. Samuel Barton that due to the default of Debtor under the Note, the Lender has no funds escrowed to pay either the 2009 property taxes or the insurance that will be due in 2010.

II. Section 362(d)(2) and Burden of Proof

7. Section 362(d)(2) permits relief from stay if:

(A) the debtor does not have any equity in such property; and

(B) such property is not necessary to an effective reorganization.

8. Pursuant to section 362(g), the Lender has the burden of proof on the issue of the Debtor's equity in property and the Debtor has the burden of proof on all other issues. All of the liens on the property must be taken into consideration in determining whether the Debtor has equity in the property. *In re Steffens*, 275 B.R. 570, 577 (Bankr. D. Colo. 2002) (citing *Indian Palms Associates, Ltd.,* 61 F.3d 197, 207 (3rd Cir. 1995); *Pistole v. Mellor (In re Mellor),* 734 F.2d 1396, 1400 n. 2 (9th Cir.1984)).

9. The Lender and Debtor disagree both as to whether there is equity in the Property and whether the Property is necessary for an effective reorganization.

A. Debt Secured by Debtor's Property

10. Mr. Harman, the Debtor's appraiser, testified that the value of the Property is $3.1 million and Mr. Lodmill, the Lender's appraiser, testified that the value of the Property is $2.3 million. (Debtor's Exs. B, p. (i); K., ¶ 13; Lender's Exs. 5, p. 98; 11, ¶ 11). The Debtor will have no equity in the Property if the Court finds that the market value of the Property is no greater than $2,754,182 or if the Court finds that there is insufficient evidence to show that the Second Deed of Trust has been released in accordance CRS §38-39-102, §38-39-103 and §38-39-107 and the debt against the Property at the time of the hearing remained at $3,233,095. The Court will address the latter issue first.

11. There is no dispute that the Second Deed of Trust encumbered the Property on the date the petition was filed and on January 7, 2010, the date that the final hearing commenced. The question is whether there was sufficient competent evidence submitted in the continued hearing on January 28, 2010 to prove that the Second Deed of Trust had been or was in the process of being released in accordance with Colorado law. There was strong evidence which clearly demonstrated that it was the intention of the holder of the Second Deed of Trust, Mr. Klaus Landau, to release the Second Deed of Trust and that he had accomplished or was accomplishing that task at the time of the hearing.

12. CRS § 38-39-102, § 38-39-103 and § 38-39-107 govern a release of deed of trust by the public trustee and the form to be used. Compliance with these sections is necessary to effect a release of the deed of trust. *Himes v. Schiro*, 711 P.2d 1281 (Colo. App. 1985). According to CRS § 38-39-102, to accomplish a release of deed of trust, the holder of the deed of trust first must sign a release of deed of trust, then take it to the public trustee. If the release substantially is in the form prescribed by CRS § 38-39-102 and C.R.S. § 38-39-103 and the fees paid, then the release is signed by the public trustee and then recorded in the real estate record of the county in which the property is located. CRS § 38-39-102(1)(b).

13. There is not any dispute as to the evidence submitted on this issue. The Debtor submitted a copy of the Second Deed of Trust marked "cancelled" by the Public Trustee of Jefferson County but marked with a future date of February 3, 2010, six days in the future. Debtor also submitted a $26 receipt from the Jefferson County Public Trustee showing Mr. Landau had delivered a document to the Public Trustee. And, Mr. Landau himself testified that he intended to release the Second Deed of Trust.

14. Having found that the Second Deed of Trust had been or was being released at the time of the hearing, I conclude the amount of debt secured by the subject Property was, only, the Movant's claim of $2,754,182 at the time of the hearing.

Market Value of the Property

15. Both the Lender's appraiser and the Debtor's appraiser submitted their respective appraisals and testified at the hearing as to their estimate of the market value of the Property. Mr. Harman's appraisal and his testimony set the market value of the Property at $3,100,000 and Mr. Lodmill's appraisal and testimony set the market value of the Property at $2,300,000. (Debtor's Ex. B, p. (i); Lender's Ex. 5, p. 98).

16. Although the difference between the two appraisals is $800,000, the appraisals are more similar than they are different and the difference seems to come from the data each appraiser used. Both appraisers are professional experienced appraisers and defined market value as the "most probable price which a property should bring in a competitive market and open market under all conditions requisite for a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus." (Ex. B, p. (ii); Ex. 5, pp. 1-2). Both appraisers agree that the market value of the Property is to be determined by a basic formula using net operating income and a capitalization rate and that to determine market value, the net operating income that a buyer would expect the Property to generate is divided by the percentage capitalization rate. (Ex. B, pp. 55-66; Ex. 5, pp. 82-97). Both appraisers use approximately the same capitalization rate as Mr. Lodmill used a rate of 8, while Mr. Harman a rate of 7.75. (Ex. B, p. 65-66; Ex. 5, p. 96). The difference between the two capitalization notes is not material and would not cause the large difference in the conclusion of market value. There is no real dispute between the appraisers' conclusions involving the type of data to be used. For gross revenue, Mr. Lodmill used a figure of $304,345. (Ex. 5, p. 97). This is virtually identical to the $306,000 figure submitted by the Debtor is his Declaration, and the Declaration of Carla Williams, who states she assists Debtor in maintaining his books and records. (Exs. I, ¶ 13; J, ¶¶ 4 and 14). Mr. Harman uses a gross income figure of $314,000. (Ex. 5, p. 65). The Debtor himself testified that the gross revenue of a fully leased Property is $306,000 per year. (Ex. I, ¶ 13).

17. The difference in the ultimate conclusion of the appraisers arises from a material difference in the operating costs for the Property used by each appraiser. Both appraisers admitted they lacked sufficient data to determine the historic operating costs for the Property. For example, Mr. Harman concluded: "Given the relative lack of comprehensive historical operating expenses, additional sources were evaluated in order to project stabilized operating

expenses." (Ex. B, p. 64). Mr. Lodmill testified in the hearing that he had contacted the Debtor and tried to get current operating data but the Debtor was unresponsive to his inquiries. Each appraiser testified that as of result of the lack of data, each appraiser turned to outside independent sources, just as they expected a third party buyer of the Property would, to determine market operating costs.

18. Mr. Lodmill's appraisal and his testimony determined the operating cost figure to be $132,059, or approximately $4,500 per unit per year. (Ex. 5, p. 97). Mr. Harman's appraisal and his testimony determined the operating costs to be $73,085, or approximately $2,500 per unit per year. (Ex. B, p. 65) This difference in operating costs results in the not insubstantial difference between the two appraisers' conclusions as to market value.

19. Using his operating cost figures, Mr. Lodmill determined the net operating income to be $172,286 ($304,345 gross revenues - $132,051 operating expenses) and, using a capitalization rate of 8, estimated the market value of the Property to be $2.3 Million. Mr. Harman determined net operating income to be $244,000 ($320,000 gross revenues - $74,000 operating costs) and, using a capitalization rate of 7.75, estimated the market value to be $3.1 Million.

20. The Court is more inclined to accept Mr. Lodmill's operating costs and is inclined to discount Mr. Harman's cost figures. Mr. Lodmill's operating cost figures are well-supported by data he considered, and an operating expense ratio of 38% is well-supported by his research on comparable units. Mr. Harman, on the other hand, arrived at an operating expense ratio of little more than 20%. The Court observes that Mr. Harman's operating expenses do not take into account routine but necessary work such as maintenance and snow removal. The testimony and evidence submitted also demonstrated that some of the tenants live in units without paying rent and instead do work, such as snow removal and maintenance in exchange for free rent. A third party buyer would calculate these costs as operating costs but Mr. Harman has not included these costs in his calculations.

21. This failure to include such normal expenses such as maintenance and snow removal is material, resulting in an increase in operating expenses of about $25,000 per year. (Debtor's Ex. E, n. 3-4.) The Court finds that a potential buyer would not include the rent in the gross revenue, while at the same time excluding the amount of free rent as an operating expense.

22. The Court finds Mr. Lodmill's estimates reasonable, realistic and reliable. Mr. Harman's estimates appear not so reasonable, realistic and reliable. Mr. Lodmill testified, both in his Declaration, and during examination in Court, as to the reasons he chose the operating cost estimates that he did. Where the estimates were similar to those of Mr. Harman, Mr. Lodmill said so. When they were higher, Mr. Lodmill explained why. Mr. Harman did not adequately explain or justify this low expense ratio either in his Declaration, or during his testimony. It appears that Mr. Harman's gross revenue figure, while only about 4% higher than Mr. Lodmill's gross revenue figure, is less reliable, as it conflicts with the Declarations of the Debtor and his bookkeeper. (Exs. I, ¶ 13; J, ¶ 14).

23. The difference between the operating expenses used by each appraiser is the most significant factor contributing to the difference between the market value of the two appraisers. The Court finds that the amount of the "free rent" could be included as an expense. I find that, using Mr. Harman's operating expense figure of approximately $74,000 per year, and adding $25,000 (Debtor's Ex. E, n. 3-4.) in operating expenses to account for the "free rent", means that the net operating revenue would likely not be higher than $207,000 ($306,000-$99,000). I find that by dividing this $207,000 net operating revenue by Mr. Harman's capitalization rate of 7.75% results in a market value of $2,670,000. The Court finds that it does not have to resolve the difference between this corrected market value of $2,670,000 and Mr. Lodmill's market value of $2,300,000 because both figures are less than the Lender's secured claim of $2,754,182. Therefore the Court finds that under this formulation there is no equity in the Property.

24. The Court reaches this conclusion, in part, because during closing arguments, the Debtor essentially conceded that by employing the usual and agreed definition of market value and normal expenses, the Debtor had no equity in the Property. The Debtor argued, without evidence or law, that because this particular Debtor does much of the work at the Property himself, has the free assistance of the witness, Ms. Williams, and trades out services for rent, his operating expenses are lower, and therefore the Property is "more valuable" to the Debtor and the estate regardless of the value to an independent third party. I find this argument not persuasive. This argument is inconsistent with the definition of market value set by the United States Supreme Court in *BFP v. Resolution Trust Corp.,* 54 U.S. 531, 114 S. Ct. 1757, 1761 (1994), which case accepted the Black's Law Dictionary 971(6th ed. 1990) definition of market price as "the price which a reasonable seller who desires to sell but is not required to sell would demand for the property and the price which a reasonable buyer who desired to buy but was not required to buy would pay for the same." This Court is bound by such a definition which looks not to what value the property holds for the particular Debtor but rather the value to a third party buyer and seller. The Court would note that both appraisers use this same concept in their definition of market value, which definition rejects Debtor's notion that appraisals should be adjusted by the unique economic arrangements and methods used by the Debtor. Further, such an approach fundamentally rejects this Court's long standing reliance on expert appraisers in relief from stay hearings. *See, e.g., In re Steffens,* 275 B.R. 570 (Bankr. D. Colo. 2002).

25. The cumulative evidence of the appraisers leads the Court to conclude that the Debtor's Property has a value in the range of $2,500,000 to $2,600,000. This is not because it is roughly midway between the two experts' appraisal values—although it is—it is because Mr. Harman's formulation simply understates, not insubstantially, operating expense for the Property, which results in overstatement of net operating income, which, in turn, results in an overstated market value. This important factor, coupled with Mr. Harmon's overstated Gross Revenue multiplier (9.0), plus his dated and dubious comparable sales used in his Sales Comparison Valuation Approach, collectively, compel the Court to this market value conclusion.

26. The Court finds and concludes that the Lender has met its burden under § 362(d)(2)(A) of the Bankruptcy Code that there is no equity in the Property.

B. The Property is not Necessary for Effective Reorganization

27. Lack of equity is not necessarily fatal under §362(d)(2) if the Debtor can prove that the property at issue is necessary to an effective reorganization. *See, e.g.*, *Matter of Baskerville,* 93 B.R. 251 (D. Colo. 1988). The Debtor has the burden of proof on this issue. *See* 11 U.S.C. §362(g)(2). To meet its burden, the Debtor must present admissible, credible evidence of a realistic prospect of reorganization, not just the hope of reorganization. *Coones v. Mutual Life of New York,* 168 B.R. 247, 259 (D. Wyo. 1994). The mere fact that the Property is indispensible to the Debtor's survival is not sufficient to deny the Lender's relief from stay motion. *See In re Holly's, Inc.,* 140 B.R. 643, 703-704 (Bankr. W.D. Mich. 1992); *see also Albany Partners Ltd. v. Westbrook,* 749 F.2d 670, 673 n. 7 (11th Cir. 1984) ("the mere fact that the property is indispensable to the debtor's survival is insufficient."). The Debtor must prove that the property is "necessary" to an "effective reorganization that is in prospect". *Timbers, 484 U.S. at 375-76*.

28. As Judge Romero stated in *In re Gunnison Center Apartments, LP*, 320 B.R. 391 (Bankr. D. Colo. 2005):

> In assessing whether a debtor can prove "a reasonable possibility of a successful reorganization within a reasonable time," courts generally apply a lesser standard in determining whether the debtor has met its burden during the 120-day exclusivity period. *See In re Apex Pharmaceuticals, Inc., 203 B.R. 432, 441* (N.D. Ind. 1996). This lesser standard has been referred to as the "sliding scale" burden of proof. However, "the use of the 'sliding scale' burden of proof is intended to benefit debtors who have a *realistic* chance of reorganization but who have not had sufficient time to formulate a confirmable plan." *Id.* at 442 (*emphasis added*).
>
> When relief from stay is requested near the expiration of the exclusivity period, the "sliding scale" or "moving target" burden of proof requires a greater showing than "plausibility." *In re Holly's, Inc., 140 B.R. at 702*. Rather, "a debtor must demonstrate that a successful reorganization within a reasonable time is probable.'" *Id.* "Probable" has been defined as having more evidence for than against or supported by evidence which inclines the mind to believe, but leaves some room for doubt or "likely." BLACK'S LAW DICTIONARY 1201 (6th ed. 1990).

Id. at 402.

29. Here also, the Debtor has passed the end of the exclusivity period on February 16, 2010 and filed a Plan of Reorganization. The Court has reviewed the Plan. However, the Court finds that the Debtor has not shown the probability of a reorganization in a reasonable period of time. Moreover, arguably, even if the lower standard of "plausible" is applied, the Debtor failed to present sufficient evidence to support the contention that his plan of reorganization, based

solely upon conversion of this rental property to condos, was plausible in a timely and cost effective fashion. In fact, the Debtor's own expert, Mr. Harman, suggested that it is not plausible to convert the apartment complex to condominiums, and that the use of the Property for apartments was the highest and best use**.** (Debtor's Ex. B, p. 44).

30. The notion of conversion may have come from Mr. Harman, who prepared a "Subdivision Development Analysis" ("SDA") wherein he concluded that if the apartments were converted and sold as condominiums, the retail sale proceeds would be $4 Million. The Debtor seemingly has adopted this hypothetical plan, and testified he "intend[s] to convert the apartment [sic] to condominiums for sale in conjunction with the Lightrail development." (Ex. I, p. 3).

31. However, during his examination, Mr. Harman testified that it is not currently legally possible to convert the apartments to condominiums, given Golden zoning regulations. In his appraisal, Mr. Harman lays the foundation for this conclusion by saying on page 26 that the property was zoned C-1 and that the current use was a legal but a non-conforming use because C-1 requires at least 25% commercial uses. On page 28 of his appraisal, Mr. Harman stated that before this Property could be converted, the Property must go through the rezoning process in Jefferson County. The Debtor presented no evidence either that the rezoning was likely or the time frames within which a rezoning could be accomplished. (Ex. I). Mr. Harmon, Debtor's appraiser, stated in his appraisal that if conversion is pursued, "the likelihood of rezoning … is unknown." (Debtor's Ex. B, p. 43).

32. Mr. Harman, Debtor's own witness, testified that it was not physically possible nor financially feasible to convert the apartment complex to condominiums. Mr. Harman admitted that he had failed to consider all of the known costs for conversion because, given the costs that he had considered, he concluded that it was not feasible to convert the apartments, and further analysis would only make it worse.

33. The uncontroverted evidence of the Debtor's own expert is that the Property must be rezoned to be converted to condominiums, and even if it could be rezoned, the evidence presented requires the conclusion that converting the apartments to condominiums is not financially probable for this Debtor.

34. In his Declaration on page 2, Mr. Tribby, the Jefferson County Planner, stated that in order to convert the Property to condominiums, the owner must purchase a water tap for each of the 5 buildings at a total cost of $325,000. The Debtor did not present evidence at the hearing, nor is there any evidence before the Court, that the debtor has $325,000 available to convert the Property. Therefore from a financial point of view based upon the evidence, conversion is not likely. As a matter of fact, Debtor's presentation of a plan of reorganization is so sketchy that it does not even address this critical financial aspect of the cost of water taps.

35. There is evidence of other expenses that Debtor has failed to consider in a plan. Currently all rents from the Property are being paid to the Lender and there is no evidence before the Court that the Debtor has the funds to pay the ordinary expenses of the Property like real property taxes which are approximately $10,000 and due in February. For the Court to find that a plan of reorganization based solely upon conversion of the Property to condominiums was

likely, the Court would have to have evidence of the ability to fund the cost of conversion. There is no evidence that the Debtor can fund ordinary costs much less extraordinary costs like water taps.

36. The Debtor testified that the alleged proximity between the Property and the future, to-be-constructed light rail station at the Jefferson County Administration Building added to the plausibility of the success of the plan. However, the Debtor's appraiser discounts Debtor's testimony when the appraisal states:

> Although the proximity to light rail is seen as a favorable factor for residential properties, it is difficult to quantify any positive impact on given property prior to completion. (Ex. B, p. 15).

Debtor's own expert could not say how the light rail would contribute to the probable success of the plan. Given that Mr. Harman could not quantify any positive significant impact from the alleged proximity to the light rail, the Debtor's unsupported assertions of significant positive impact from the location of the Property are entitled to limited weight.

37. The Debtor also submitted a Declaration of his bookkeeper, Carla Williams, who repeats Mr. Koch's unsupported assertions that: "Mr. Koch intends to convert the apartment to condominiums for sale in conjunction with the Lightrail development." (Ex. J, ¶ 20). Ms. Williams' testimony only highlights the fact that the Debtor has, largely, a *hope* to convert the Property to condos but no realistic plan—and even that hope is undermined by his own expert's testimony.

38. During closing argument, the Debtor appealed to the sympathy of the Court, as a court of equity, to recognize the fact that the Debtor has begun to pay the interest due to the Lender and this Court should find that the Debtor should be given a chance to reorganize. The Debtor's argument that the Property generates sufficient cash flow, at the moment, to make interest payments to the Lender is insufficient to prove that the Property is necessary for an effective reorganization. *See, e.g., In re Steffens,* 275 B.R. 570, 578 (Bankr. D. Colo. 2002) (debtor's testimony and argument that they had sufficient income to make payments to bank under a plan held insufficient to prove necessity). Instead, as noted above, "a debtor must demonstrate that a *successful reorganization within a reasonable time is probable*." *In re Gunnison Center Apartments, LP*, 320 B.R. 391 (Bankr. D. Colo. 2005) (emphasis added). Notably, there is no evidence of the time frames to rezone, no evidence of the likelihood of successful rezoning, no evidence of the cash to convert, no evidence of the cash to carry the normal expenses of the Property, and no evidence of how this Property fits with the Debtor's other properties in a plan of reorganization, and how the conversion can be accomplished and the condominiums individually sold with the Lender's lien encumbering all of the Property. Although it is true that this Court is one of equity, it is also true that "Equity follows the law" and this Court cannot ignore the plain meaning of section 362(d)(2), or case law construing that statute and must find that the Debtor has failed to prove "that a successful reorganization within a reasonable time is probable" or plausible.

39. The Court finds that the Debtor has failed to meet its burden of proof as to the feasibility of a prospective plan of reorganization under the *Timbers* standards. The testimony presented does not indicate that a successful plan is "probable," or even, arguably, "plausible."

III. Conclusion

40. Based upon the evidence, this Court concludes that there is no equity in the Property and the Property is not necessary for an effective reorganization.

IV. Order

IT IS THEREFORE ORDERED that the Motion for Relief from Stay filed by 17250 West Colfax Holdings, LLC shall be and is hereby GRANTED pursuant to 11 U.S.C. §362(d)(2).

Dated this 9th day of April, 2010.

BY THE COURT:

Sid Brooks

Sidney B. Brooks,
United States Bankruptcy Judge